

Colgate Palmolive

STOCK INFO.	BLOOMBERG
BSE Sensex: 9,550	CLGT IN
	REUTERS CODE
S&P CNX: 2,908	COLG.BO

24 January 2006

Buy
Previous Recommendation: Buy
Rs282

Equity Shares (m)	136.0
52-Week Range (Rs)	296/169
1,6,12 Rel. Perf. (%)	0/-8/4
M.Cap. (Rs b)	38.4
M.Cap. (US\$ B)	0.9

YEAR	NET SALES	PAT	EPS	EPS	P/E	P/BV	ROE	ROCE	EV/	EV/
END	(RS M)	(RS M)	(RS)	GROWTH (%)	(X)	(X)	(%)	(%)	SALES	EBITDA
03/05A	9,642	1,133	8.3	4.9	33.9	15.4	45.4	70.7	3.8	21.7
03/06E	10,971	1,668	12.3	47.2	23.0	13.4	58.2	76.3	3.3	17.2
03/07E	12,395	2,067	15.2	23.9	18.6	11.6	62.2	79.9	2.9	14.2

- 3QFY06 results were ahead of expectations driven by strong volume growth and expanding operating margins.
- Net sales grew 21.2% YoY with overall volumes growing 14% YoY. The toothbrush category grew by a strong 54% in unit volume terms on a YoY basis and recorded 8% volume growth for the 9MFY06. Revenue growth was further aided by higher price realizations in toothpaste due to price hikes adopted in April 2005. Net sales have also been aided by lower excise duties due to increased production at its Baddi plant.
- EBITDA margins expanded 580bp driven largely by production efficiencies of the Baddi plant. The company is shifting incremental production to Baddi, thereby reducing its dependence on outsourced products leading to margin expansion.
- Colgate booked extraordinary expenses of Rs165m on account of impairment of assets and additional depreciation on account of change in the estimates of the useful life of the assets.
- Effective income tax rates for the company were down to 18.5% in 3QFY06 against 32.2% in 3QFY05, primarily due to income tax benefits enjoyed on production at the Baddi plant.
- We are revising our EPS estimates upward for FY06 and FY07 by 15.5% and 14.2% respectively to adjust for higher margins and income tax benefits resulting from production at Baddi plant. We are introducing our FY08E EPS at Rs18.1. The stock is currently valued at 23x FY06E, 18.6x FY07E and 15.6x FY08E EPS. We maintain **Buy**.

QUARTERLY PERFORMANCE

(Rs Million)

Y/E MARCH	FY05				FY06				FY05	FY06E
	1Q	2Q	3Q	4Q	1Q	2Q	3Q	4QE		
Net Sales	2,427	2,457	2,358	2,400	2,583	2,781	2,857	2,750	9,642	10,971
YoY Change (%)	6.8	6.5	-5.8	3.8	6.4	13.2	21.2	14.6	2.7	13.8
Total Exp	-2,023	-2,015	-1,906	-1,962	-2,167	-2,350	-2,143	-2,213	-7,906	-8,873
EBITDA	404	442	452	438	416	432	714	537	1,736	2,098
Margins (%)	16.6	18.0	19.2	18.3	16.1	15.5	25.0	19.5	18.0	19.1
Depreciation	-46	-48	-45	-58	-26	-39	-47	-54	-197	-165
Interest	-3	-3	-4	-2	-2	-1	-1	-2	-12	-6
Other Income	56	54	107	126	106	51	49	47	342	253
PBT	411	446	510	504	494	443	715	528	1,870	2,180
Tax	-156	-176	-164	-170	-140	-134	-132	-107	-666	-512
Rate (%)	38.0	39.5	32.2	33.7	28.2	30.2	18.5	20.2	35.6	23.5
PAT	255	270	345	335	355	309	583	422	1,204	1,668
YoY Change (%)	23.1	16.4	25.8	-8.8	39.2	14.5	68.7	26.0	11.5	38.5
Extraordinary Expenses	0	0	-60	-11	-75	0	-165	0	-71	-240
Reported PAT	255	270	285	323	280	309	417	422	1,133	1,428

E: MOST Estimates

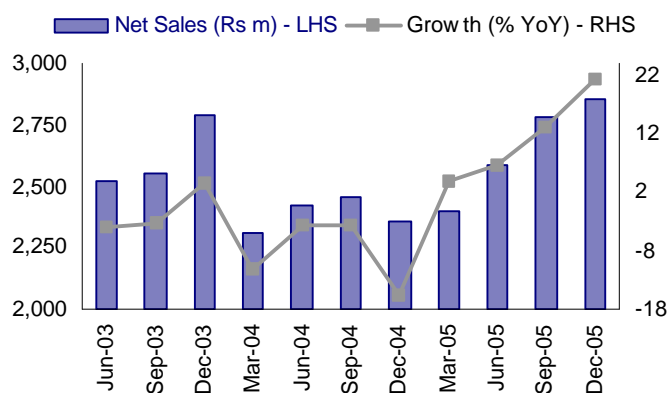
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Strong volume growth drives overall revenues

Colgate reported its strongest revenue growth in more than three years buoyed by strong volume growth of 14% and better price realizations in toothpastes due to a 5% price hike in this category adopted by the company in April 2005. Volume growth was particularly robust in the current quarter indicating an accelerating demand scenario. Toothbrush volumes were up 54% and 8% YoY for the quarter and 9MFY06 respectively. Lower excise duties due to higher production at the company’s Baddi plant further aided growth in net sales. The company discontinued sales of toilet bar soaps from the current quarter. Excluding toilet soaps business, net revenues grew 23% and 15% YoY for the quarter and 9MFY06 respectively. The company launched new products in the toothpaste category (new Colgate Max Fresh) and relaunched products in the toothbrush category (Colgate Super Flexi and Extra Clean, Sensitive, Zig Zag and Zig Zag Plus in the premium and super premium segments) during the quarter.

We had mentioned in our 2QFY06 results that we believe the company was witnessing selective uptrading, especially in urban areas. We believe that the current quarter’s volume growth indicates buoyant demand even in rural areas. New product launches by the company have contributed to the strong growth reported by the company.

STRONG VOLUME GROWTH DRIVES REVENUES



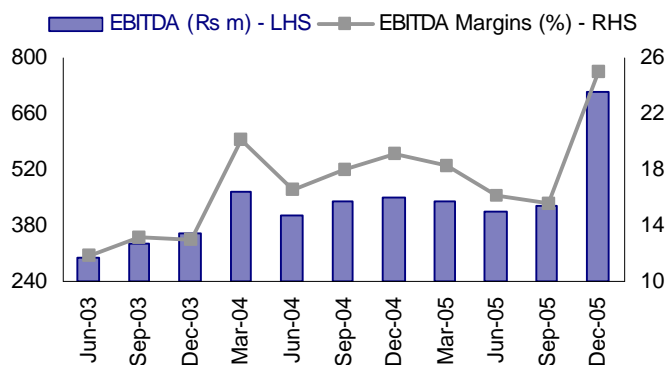
Source: Company/Motilal Oswal Securities

Production at Baddi drives expansion in operating margins

The company commenced commercial production from its Baddi plant in August 2005 and completed its first full quarter of commercial production in December 2005. The company is shifting incremental production to Baddi, thereby reducing the purchase of finished goods. This has enabled the company to expand its gross margins by 780bp YoY in 3QFY06.

However, the EBITDA margins for the company expanded only 580bp as the company continued to invest in advertising. Higher staff costs have also impacted expansion in EBITDA margins. We expect the company to continue to shift incremental production to Baddi, thereby expanding gross margins. However, we believe that significant portion of these benefits would be invested in the business through higher advertising spends to improve penetration as Oral Care continues to be a relatively low penetrated category.

HIGHEST EBITDA MARGINS IN OVER 3 YEARS



Source: Company/Motilal Oswal Securities

Lower income tax expense boosts bottom line growth

Tax benefits from production at the company’s Baddi plant resulted in the lower effective income tax rates at 18.5% in 3QFY06 against 32.2% in 3QFY05, thereby boosting PAT growth. We believe that effective tax rate for the company is likely to trend downwards as production from the Baddi plant increases.

Revising estimates

We are increasing our EPS estimates for FY06 and FY07, adjusting for the expanding margins on account of production at Baddi and likely lower income tax rates going forward. We have increased our FY06E EPS and FY07E EPS by 15.5% and 14.2% respectively.

REVISED ESTIMATES

	FY06E			FY07E		
	OLD	NEW	VAR	OLD	NEW	VAR
Revenues	10,912	10,971	0.5	12,328	12,395	0.5
<i>Growth (%)</i>	13.2	13.8		13.0	13.0	
<i>EBITDA Margin</i>	17.1	19.1		18.1	20.3	
Net Profit	1,445	1,668	15.5	1,810	2,067	14.2
<i>Growth (%)</i>	27.5	47.3		25.3	23.9	
EPS (Rs)	11	12	15.5	13	15	14.2
<i>Growth (%)</i>	27.5	47.3		25.3	23.9	

Source: Company/Motilal Oswal Securities

Valuation and view

We are buoyed by strong volume growth and improved margins posted by the company. We expect volume growth to remain strong. However, the higher advertising spend could limit overall expansion in margins. We are however convinced that the higher ad-spend would result in higher sales going forward. We expect the company to report EPS of Rs12.3 and Rs15.2 for FY06 and FY07 respectively. We are introducing our FY08E EPS at Rs18.1. The stock is currently trading at 23x FY06E, 18.6x FY07E and 15.6x FY08E earnings. We reiterate **Buy** with a price target of Rs360 at 20x FY08E earnings.

Colgate Palmolive: an investment profile

Company description

Colgate is a market leader in the toothpaste segment with a market share of 50%. With the relaunch of Cibaca Top in early CY04 the company has captured 38% of low price segment. Oral care is one of the most underpenetrated segments of the FMCG market with a penetration of 32%. Colgate has invested Rs700m in a toothpaste facility at Baddi in Himachal Pradesh which will accrue fiscal benefits.

Key investment arguments

- Colgate has regained its leadership position in the oral care market. In FY05, it grew 14% in volumes compared to 9% industry growth.
- Pricing environment has improved as is evident by the latest price hikes. This would aid margin improvement.

Key investment risks

- P&G's entry in the oral care market with its Crest brand, at a lower price point than Colgate.
- Higher input cost prices could affect margins.

Recent developments

- Announced the launch of its innovative new product – “New Colgate Max Fresh”, a unique gel based toothpaste with dissolvable cooling crystals.
- Colgate raised prices across its toothpaste brands by approximately 5% with effect from April 2005.
- Launched Colgate Active Salt, claimed to be the first toothpaste in India to contain salt.

Valuation and view

- We expect Colgate to report an EPS CAGR of 29% over FY05-08.
- The stock is currently valued at 23x FY06E, 18.6x FY07E and 15.6x FY08E earnings. We maintain **Buy**.

Sector view

- We are Neutral on the sector. There are signs of volume pickup, but input cost pressure remains
- Companies with low competitive pressures (like ITC) will be better off.
- Longer term prospects bright, given rising incomes and low penetration

COMPARATIVE VALUATIONS

		COLGATE	HLL	NESTLE
P/E (x)	FY06E	23.0	29.4	27.3
	FY07E	18.6	25.7	23.9
EV/EBITDA (x)	FY06E	17.2	25.4	16.7
	FY07E	14.2	22.4	14.6
EV/Sales (x)	FY06E	3.3	3.2	3.6
	FY07E	2.9	2.9	3.3
P/BV (x)	FY06E	13.4	17.7	25.3
	FY07E	11.6	16.2	21.8

SHAREHOLDING PATTERN (%)

	DEC.05	SEP.05	DEC.04
Promoters	51.0	51.0	51.0
Domestic Institutions	12.6	13.7	12.1
FII's/FDIs	7.4	5.4	4.3
Others	28.9	29.9	32.6

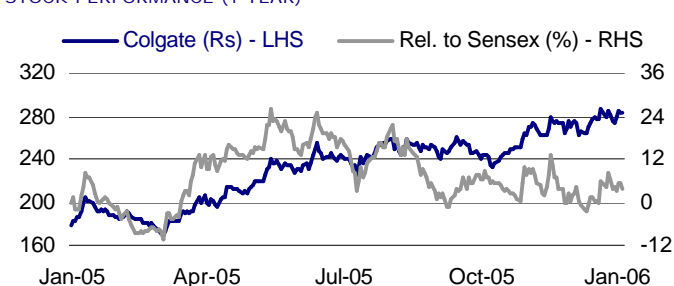
EPS: INQUIRE FORECAST VS CONSENSUS (RS)

	INQUIRE FORECAST	CONSENSUS FORECAST	VARIATION (%)
FY06	12.6	10.2	23.5
FY07	15.2	13.1	16.0

TARGET PRICE AND RECOMMENDATION

CURRENT PRICE (RS)	TARGET PRICE (RS)	UPSIDE (%)	RECO.
282	360	27.6	Buy

STOCK PERFORMANCE (1 YEAR)



INCOME STATEMENT		(RS MILLION)				
Y/E MARCH	2004	2005	2006E	2007E	2008E	
Net Sales	9,392	9,642	10,971	12,395	13,881	
Change (%)	-0.9	2.7	13.8	13.0	12.0	
Total Expenditure	-7,928	-7,968	-8,873	-9,883	-10,939	
EBITDA	1,464	1,674	2,098	2,512	2,942	
Change (%)	12.3	14.4	25.3	19.7	17.1	
Margin (%)	15.6	17.4	19.1	20.3	21.2	
Depreciation	-243	-224	-165	-202	-214	
Int. and Fin. Charges	-6	-12	-6	-6	-6	
Other Income	299	342	253	346	353	
Profit before Taxes	1,515	1,781	2,180	2,649	3,075	
Change (%)	3.4	17.6	22.4	21.5	16.0	
Margin (%)	16.1	18.5	19.9	21.4	22.2	
Tax	-590	-700	-512	-583	-615	
Deferred Tax	155	52	0	0	0	
Tax Rate (%)	-28.7	-36.4	-23.5	-22.0	-20.0	
Profit after Taxes	1,080	1,133	1,668	2,067	2,460	
Change (%)	2.18	4.9	47.2	23.9	19.0	
Margin (%)	11.5	11.7	15.2	16.7	17.7	
Reported PAT	1,080	1,133	1,428	2,067	2,460	

BALANCE SHEET		(RS MILLION)				
Y/E MARCH	2004	2005	2006E	2007E	2008E	
Share Capital	1,360	1,360	1,360	1,360	1,360	
Reserves	1,083	1,138	1,505	1,963	2,589	
Net Worth	2,443	2,498	2,865	3,323	3,949	
Loans	22	40	0	0	0	
Deferred Liability	1	-50	-100	-150	-200	
Capital Employed	2,466	2,487	2,765	3,173	3,749	
Gross Block	3,212	3,244	3,944	4,192	4,392	
Less: Accum. Depn.	-2,314	-2,447	-2,612	-2,814	-3,028	
Net Fixed Assets	898	797	1,332	1,378	1,364	
Capital WIP	42	675	40	40	40	
Investments	1,159	1,608	1,810	2,228	2,846	
Curr. Assets, L&A	3,300	2,493	2,534	2,597	2,673	
Inventory	617	745	782	822	873	
Account Receivables	326	174	177	200	224	
Cash and Bank Balance	1,280	561	561	561	561	
Others	1,077	1,014	1,014	1,014	1,014	
Curr. Liab. and Prov.	2,932	3,122	2,952	3,070	3,173	
Account Payables	1,531	1,634	1,683	1,734	1,786	
Other Liabilities	1,026	785	808	841	876	
Provisions	375	702	460	495	511	
Net Current Assets	368	-593	-417	-473	-501	
Application of Funds	2,466	2,487	2,765	3,173	3,749	

E: MOST Estimates

RATIOS						
Y/E MARCH	2004	2005	2006E	2007E	2008E	
Basic (Rs)						
EPS	7.9	8.3	12.3	15.2	18.1	
Cash EPS	9.7	10.0	13.5	16.7	19.7	
BV/Share	18.0	18.4	21.1	24.4	29.0	
DPS	6.0	7.0	8.5	10.5	12.0	
Payout %	85.2	95.2	78.0	77.7	74.6	
Valuation (x)						
P/E		33.9	23.0	18.6	15.6	
Cash P/E		28.3	21.0	16.9	14.4	
EV/Sales		3.8	3.3	2.9	2.5	
EV/EBITDA		21.7	17.2	14.2	11.9	
P/BV		15.4	13.4	11.6	9.7	
Dividend Yield (%)		2.5	3.0	3.7	4.2	
Return Ratios (%)						
RoE	44.2	45.4	58.2	62.2	62.3	
RoCE	61.7	70.7	76.3	79.9	78.0	
Working Capital Ratios						
Debtor (Days)	-14	-9	-6	-6	-6	
Asset Turnover (x)	7.4	47.2	12.0	13.7	16.1	
Leverage Ratio						
Debt/Equity (x)	0.0	0.0	0.0	0.0	0.0	

CASH FLOW STATEMENT		(RS MILLION)				
Y/E MARCH	2004	2005	2006E	2007E	2008E	
OP/(loss) before Tax	1,464	1,674	2,098	2,512	2,942	
Int./Div. Received	299	342	253	346	353	
Interest Paid	-6	-12	-6	-6	-6	
Direct Taxes Paid	-590	-700	-512	-583	-615	
(Incr)/Decr in WC	222	278	-211	56	27	
CF from Operations	1,390	1,583	1,622	2,325	2,701	
(Incr)/Decr in FA	-38	-665	-65	-248	-200	
(Pur)/Sale of Investments	-107	-449	-362	-418	-618	
CF from Invest.	-145	-1,114	-427	-666	-818	
Issue of Shares	0	0	0	0	0	
(Incr)/Decr in Debt	0	18	-40	0	0	
Dividend Paid	-920	-1,078	-1,300	-1,606	-1,836	
Others	-30	-127	146	-53	-47	
CF from Fin. Activity	-950	-1,187	-1,194	-1,659	-1,883	
Incr/Decr of Cash	295	-718	0	0	0	
Add: Opening Balance	985	1,280	561	561	561	
Closing Balance	1,280	561	562	561	562	

E: MOST Estimates



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Colgate Palmolive

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| 1. Analyst ownership of the stock | No |
| 2. Group/Directors ownership of the stock | No |
| 3. Broking relationship with company covered | No |

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